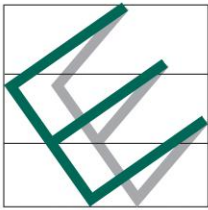


GEORGIA

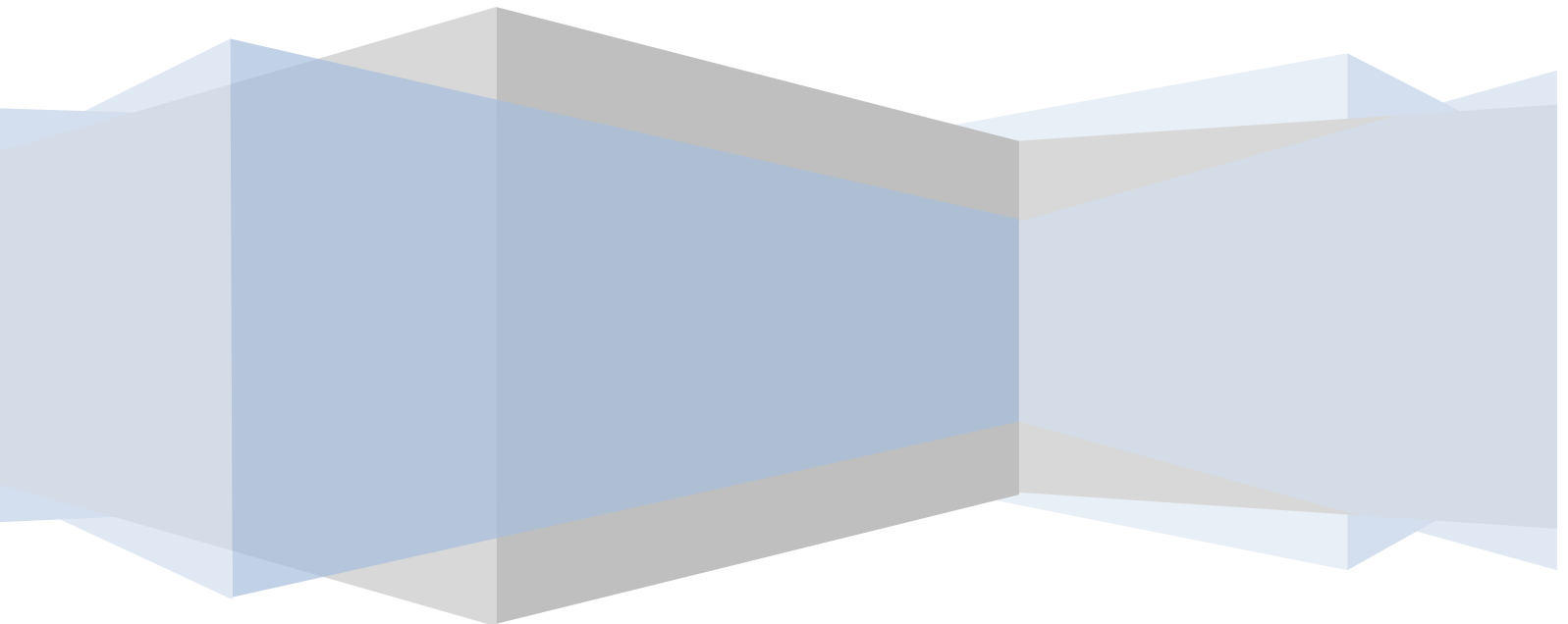
PERFORMANCE

STANDARDS

Unit 4: “Government and the Economy – Superhero or Villain”



**Georgia Council on
Economic Education**



GEORGIA PERFORMANCE STANDARDS

SSEF4 The student will compare and contrast different economic systems, and explain how they answer the three basic economic questions of what to produce, how to produce and for whom to produce.

Every society must contend with the problem of scarcity. Every society, regardless of its political structure, must develop an economic system to determine how to use its limited productive resources to answer the three basic economic questions.

What goods and services will be produced?

How will goods and services be produced?

Who will consume the goods and services?

The way a society answers these questions determines its economic system.

Three types of economic systems exist to answer these questions.

Traditional – In a traditional economy, economic decisions are based on custom and historical precedent.

Command – In a *centralized* command economy, government planning groups make the basic economic decisions. They determine such things as which goods and services to produce, their prices, and wage rates.

Market – In a *decentralized* market economy, economic decisions are guided by the changes in prices that occur as individual buyers and sellers interact in the market place (which it is also referred to as a price system). Other names for market systems are free enterprise, capitalism, and laissez-faire.

There are no pure command or market economies. To some degree, all modern economies exhibit characteristics of both systems and are often referred to as **mixed** economies. However, most economies are closer to one type of economic system than another.

Market economies rely primarily on the price system to answer these questions. For example, suppose a new craze for tennis results in consumers purchasing more tennis rackets. If this is the only change in the market, the increase in demand for tennis rackets will cause their **price** (the amount people pay when they buy a good or service or the amount they receive when they sell a good or service) to rise, resulting in more **profits** for producers of tennis rackets. The rise in profits will encourage existing producers to make and sell more rackets. It will also encourage new racket producers to enter the market, encouraging **competition** from new **businesses** (an organization that produces or exchanges goods or services for a profit). Eventually, the supply of tennis rackets will increase and the price will fall.

a. compare command, market, and mixed economic systems with regard to private ownership, profit motive, consumer sovereignty, competition, government regulation

Economic systems are those institutional frameworks of formal and informal rules that a society uses to determine what to produce, how to produce and for whom.

Economic systems can be categorized according to who makes most of the decisions in an economy. In a market economy, most of the decisions in the economy about what to produce, how to produce it and who receives it are made by individuals and firms. At the other end of the spectrum, in a command economy, government officials make most of the decisions in the economy about what to produce, how to produce it and who receives it. Most economic systems also contain elements of tradition or repeating decisions in ways made at an earlier time or by an earlier generation. Most economies are mixed in that some economic decisions are made by individuals and private firms, but some are also made by government officials, either through rules and regulations or through government-owned firms. The U.S. economy leans toward the market-oriented side of the spectrum. An economy like Cuba or North Korea is near the command economy side of the spectrum. But the dividing line between market and command economies in most nations is blurry rather than bright.

Command (centralized) Economy

An economy in which most economic issues of production and distribution are resolved through central planning and control.

Market (decentralized) Economy

An economy that relies on a system of interdependent market prices to allocate goods, services, and productive resources and to coordinate the diverse plans of consumers and producers, all of them pursuing their own self-interest.

Mixed Economy

There are no pure command or market economies. To some degree, all modern economies exhibit characteristics of both systems and are, therefore, referred to as “mixed”.

Profit Motive

The desire to make money which motivates or causes people to work hard to produce goods and services.

Consumer Sovereignty

The extent to which people are free to choose in the marketplace without government regulation

Competition

Attempts by two or more individuals or organizations to acquire the same goods, services, or productive and financial resources. Consumers compete with other consumers for goods and services. Producers compete with other producers for sales to consumers.

Governmental Regulation

The extent to which government intervenes in the decisions of buyers and sellers in a market

b. evaluate how well each type of system answers the three economic questions and meets the broad social and economic goals of freedom, security, equity, growth, efficiency and stability

Economic Freedom

The freedoms of the marketplace--the freedom of consumers to decide how they wish to allocate their spending among various goods and services; the freedom of workers to choose to change jobs; the freedom of individuals to establish businesses and to decide what to produce and when to change their pattern of production; and the freedom of savers to decide when and where to invest their savings.

Economic Security

Protection against economic risks, such as unemployment, accidents on the job, business failures or natural disasters, over which people have little or no control. Economic security refers to protecting consumers, producers, and resource owners from risks that exist in society. Each society must decide from which uncertainties individuals can and should be protected, and whether individuals, employers, or the government should provide or pay for this protection.

Economic Equity

The application of our concepts of what is "fair" or "unfair" and what is "right" or "wrong" to an economic policy. Ultimately deals with the distribution of income and wealth. Some people judge equity based on providing equal opportunity. Others judge based on equality of outcomes.

Economic Growth

Increasing the production of goods and services over time. Economic growth is measured by changes in the level of real gross domestic product (GDP). A target annual growth rate of 3 to 4 percent in real GDP is generally considered to be reasonable and sustainable.

Economic Efficiency

A situation in which no one in a society can be made better off without making someone else worse off. The gains for society must be more than the costs to that society. Economic efficiency refers to how well scarce productive resources are allocated to produce the goods and services people want and how well inputs are used in the production process to keep production costs as low as possible.

Economic Stability

This is the process of maintaining stable prices and full employment and keeping economic growth reasonably smooth and steady. Price stability means avoiding inflation or deflation. Full employment occurs when an economy's scarce resource, especially labor, are fully utilized.

SSEF5 The student will describe the roles of government in a market economy.

Government has an active role in establishing a framework or rules of the game in economic life. In the United States, this activity involves preserving and fostering competition, regulating natural monopolies, providing information and services to enable the market to work better, regulating externalities, providing certain public goods, offering some economic security and income redistribution to individuals,

assuring a sound monetary system and promoting overall economic stability and growth.

Markets perform well in providing most goods and services of everyday life: groceries, restaurant meals, clothing, movies and cars. Nevertheless, there is a role for government in areas where markets fail or are inefficient. Some roles of government include protecting the environment, helping the poor and providing national defense. In these cases, there is a role for government to provide economic security and foster competition. Governments also provide public goods. Public goods are those that cannot easily be restricted to those who pay for them. For most public goods, consumption by one person does not reduce the amount of the good available to others. Political opinions differ about how extensive the role of government should be in managing the economy. But even those who favor a primarily market-oriented economy usually concede that markets also need a backdrop of a rule of law to function well, in which the government enforces contracts and protects property rights. The paradox of good government is that it must be strong enough to perform its appropriate roles, but weak enough that it does not intervene excessively in people's lives. Although there is a role for government, we cannot assume that it will perform that role well. There are and have been policies that hurt the poor, harm the environment and protect monopolies.

a. explain why government provides public goods and services, redistributes income, protects property rights and resolves market failures.

Public Goods and Services

Most goods and services produced in the marketplace are private goods and services. This kind of good or service is purchased by a consumer who desires it and can afford it, and then consumed only by that individual or anyone he or she gives it to. But some goods and services must be produced by the public sector or government. Public goods and services are paid for through tax dollars and are available to everyone, even those who do not pay taxes. That means taxpayers have an incentive to use public goods, and try to get more of them produced, while shirking tax burdens to others. This is known as “free riding.”

Public goods are characterized by shared consumption and nonexclusion. Nonexclusion means that it is difficult to exclude nonpayers from receiving the benefit of a good or service once it is produced. Shared consumption means that the consumption of a good or service by one individual does not reduce the amount available for others to consume. Although many goods and services are produced by the government, only those that exhibit these two characteristics, shared consumption and nonexclusion, are considered pure public goods.

Income Redistribution

Income distribution refers to how the total income earned ends up divided over members of the economy. One common method of describing the income distribution is to divide the population into equal-sized groups, and then to say what share of income is received by each group. For example, in the United States in recent years, the bottom fifth of all households ranked by income have received about 4 percent of

all income earned in a given year; the second fifth, 10 percent; the third fifth, 16 percent; the fourth fifth, 23 percent; and the top fifth, 47 percent.

A perfectly equal income distribution would mean that everyone receives exactly the same income. However, there is no reason to expect a perfectly equal income distribution. After all, some people are in their 20s, some in their 50s, and some in their 80s--so incomes are different in a given year because of where people are in their life cycle. Some people pursue careers that require higher levels of skills; others do not. Some people choose to work extra jobs to earn additional income; others do not. Also, the income distribution in any given year does not reveal how many people are moving higher or lower in the income distribution over time. Given these complications, whether the level of income inequality in the current income distribution should be viewed as fair, unfair or somewhere in between is a controversial issue. In fact, even people's definition of "fair" can differ dramatically.

The functional distribution of income refers to how income is divided among wages, interest, rents and profits. In the U.S. market economy, the bulk of total income goes to wages. About three-fourths of our national income is wages. When demagogues claim that most income goes to business profits or rents to large landowners, this is factually wrong.

Property Rights

Property rights refer to the legal ownership of resources, which include the right to own, use and sell them. Property rights are essential to the transactions in a market economy, and one of the essential roles of government in a market-oriented economy is to protect property rights. When goods, including everything from cars to groceries, are bought and sold, a property right is transferred from one party to the other. Your ownership of your own labor, that is, your property rights in your own labor, is what gives you the right to be paid for your work. Without property rights and ownership, firms would lack any reason to build factories, produce and innovate, because they wouldn't be able to keep what they made or earned. Similarly, people and firms would have a greatly reduced incentive to save or invest, because they wouldn't be confident of receiving the future value from doing so.

Market Failures

A market succeeds when it brings together a willing buyer and willing seller to make a mutually beneficial transaction in a way that satisfies the parties involved. However, there are certain well-recognized conditions under which market failure occurs; this means either that a market transaction affects third parties not involved in the transaction or that a market has difficulty in providing certain kinds of products.

Here are some examples of market failure. First, externalities are situations in which a market transaction affects a third party who is not part of the transaction. A classic example is pollution, where people who do not purchase the good whose production created the pollution must nevertheless face polluted air or water. A second market failure is one in which the private market is unable to provide the good or service. Two examples of this are national defense and police protection. It is very difficult for the private market to charge individuals for these services. This

means that this role falls to the Government. Although not a market failure, it is interesting to note that the Federal Government is also unable exclude individuals from these services for failure to pay their taxes. The difference is that the Federal Government is not expected to make a profit from their services. Third, a monopoly firm that operates without competition, and thus has the power to increase the prices it charges to consumers, is an example of market failure. Imperfect information is often cited as a market failure. Ideally all market participants would have perfect information, and it is often argued that markets fail when buyers and sellers have imperfect information. But buyers and sellers always have less than perfect information. Indeed, any attempt to acquire perfect information would be inefficient because it would soon begin costing more than it was worth. Also, it should be emphasized that the prices that emerge from market exchanges provide buyers and sellers with far more information relevant to their decisions than would otherwise be available.

b. give examples of government regulation and deregulation and their effects on consumers and producers.

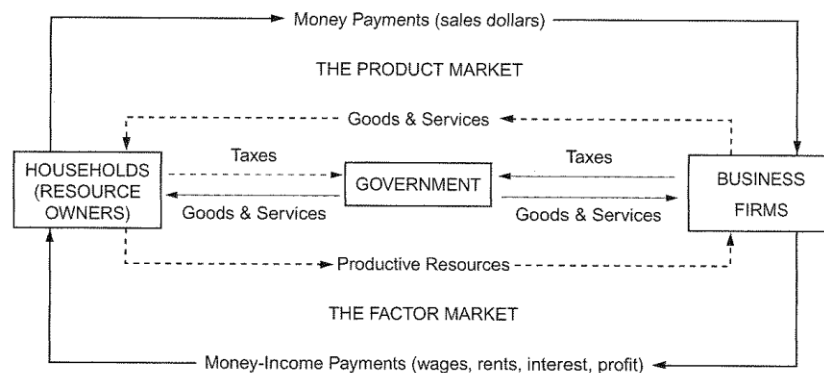
Is there too much government regulation or too little? Who answers that question, and on what basis? Many critics have cited the total cost of government regulation and claimed that there is too much regulation. The U.S. Office of Management and Budget recently provided a report to Congress on the overall costs and benefits of federal regulations suggesting that the critics have failed to accurately consider all of the benefits resulting from regulation. The report goes on to emphasize the importance of applying cost-benefit analysis when making changes in regulatory policy – in other words comparing the expected costs of a new policy or a change in an existing policy to the expected benefits.

SSEMA1 The student will illustrate the means by which economic activity is measured.

a. Explain that overall levels of income, employment, and prices are determined by the spending and production decisions of households, businesses, government, and net exports.

Increased levels of spending by households, businesses, government and purchasers of exported goods and services increase aggregate demand. Overall levels of income, employment and prices are derived from the equilibrium established through the aggregate supply/aggregate demand model. Real output at a particular price level reflects the employment and real wages established in the economy as an aggregate.

Circular Flow



b. Define Gross Domestic Product (GDP), economic growth, unemployment, Consumer Price Index (CPI), inflation, stagflation, and aggregate supply and aggregate demand.

Gross Domestic Product (GDP)

The market value of all final goods and services produced in a country in a calendar year.

Economic Growth

An increase in real output as measured by real GDP or per capita real GDP.

Unemployment

The number of people in the civilian work force over the age of 16 without jobs who are actively seeking work.

Consumer Price Index (CPI)

A price index that measures the cost of a fixed basket of consumer goods and services and compares the cost of this basket in one time period with its cost in some base period. Changes in the CPI are used to measure inflation.

Inflation

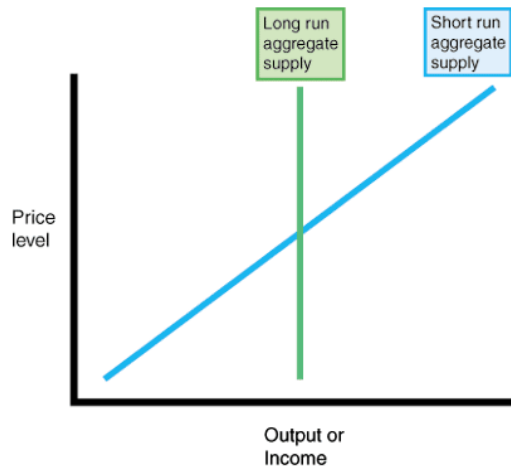
A rise in the general or average price level of all the goods and services produced in an economy. Can be caused by pressure from the demand side of the market (demand-pull inflation) or pressure from the supply side of the market (cost-push inflation).

Stagflation

A decline in real GDP combined with a rise in the price level.

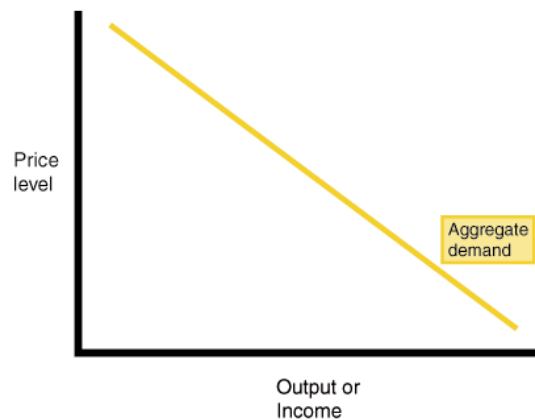
Aggregate Supply (AS)

A schedule (or graph) that shows the value of output (real GDP) that would be produced at different price levels.



Aggregate Demand (AD)

A schedule (or graph) that shows the value of output (real GDP) that would be demanded at different price levels.



c. Explain how economic growth, inflation, and unemployment are calculated.

The government calculates economic growth by using the expenditure approach or income approach in measuring GDP. GDP is a measure of a nation's economic output and income. It is the total market value, measured in dollars, of all goods and services produced within a country's borders in one year.

The Consumer Price Index (CPI) is the most commonly used measure of price-level changes in the economy. It can be used to compare price levels and inflation among various years. The CPI is determined by comparing the price of a standard group of goods called a “market basket” to the price of the same group of goods in a previous month of year.

To calculate unemployment the government conducts a monthly census of about 50,000 families. These families are asked about their employment status during that month. This poll tells the government how many people are employed and how many people are unemployed. These numbers are then used to calculate the unemployment rate. To calculate the unemployment rate the government divides the number of people unemployed by the number of people in the civilian labor force and then multiplies that number by 100.

Bureau of Economic Analysis- www.bea.gov (economic growth)

Bureau of Labor Statistics- www.bls.gov (inflation, unemployment)

d. Identify structural, cyclical, and frictional unemployment.

Structural Unemployment

The type of unemployment resulting from people's present abilities, skills, training and location not matching up with available job openings that reflect the basic structure of the economy.

Cyclical Unemployment

Unemployment caused by fluctuations in the overall rate of economic activity or phase of the business cycle.

Frictional Unemployment

Unemployment that is always present in the economy, resulting from temporary transitions made by workers and employers or from workers and employers having inconsistent or incomplete information.

e. Define the stages of the business cycle, include peak, contraction, trough, recovery, expansion as well as recession and depression.

Business cycle

Fluctuations in the overall rate of national economic activity with alternating periods of expansion and contraction; these vary in duration and degrees of severity; usually measured by real gross domestic product (GDP).

Peak

The height of an economic expansion, when real GDP stops rising.

Contraction

A period of economic decline marked by falling real GDP.

Trough

The lowest point in an economic contraction, when real GDP stops falling.

Recovery

A period in a business cycle following a recession, during which the real GDP rises.

Expansion

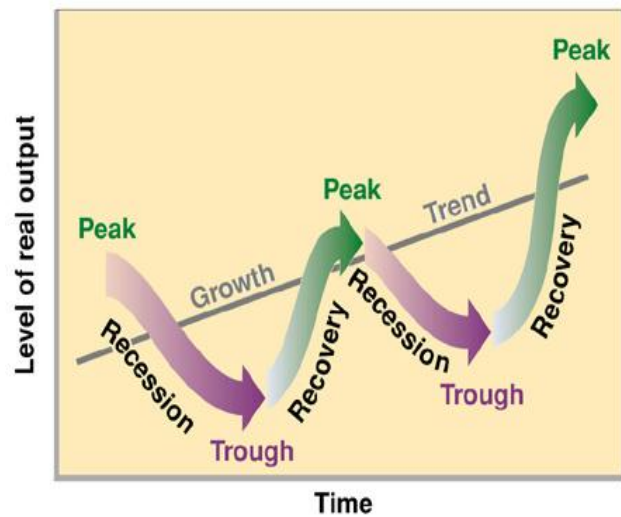
A period of economic growth as measured by a rise in real GDP.

Recession

A decline in the rate of national economic activity, usually measured by a decline in real GDP for at least two consecutive quarters (i.e., six months).

Depression

A severe, prolonged economic contraction.



f. Describe the difference between the national debt and government deficits.

National Debt

The total amount owed by the national government to those from whom it has borrowed to finance the accumulated difference between annual budget deficits and annual budget surpluses; also called public debt.

Government Deficits

A government spends more money (expenditures) in a fiscal year than it takes in (revenue) during that time.

SSEMA2 The student will explain the role and functions of the Federal Reserve System.

a. Describe the organization of the Federal Reserve System.

Its main function is controlling the money supply through monetary policy. The Federal Reserve System divides the country into 12 districts, each with its own Federal Reserve bank. Each district bank is directed by its nine-person board of directors. The Board of Governors, which is made up of seven members appointed by the President and confirmed by the Senate to 14-year terms, directs the nation's monetary policy and the overall activities of the Federal Reserve. The Chairman of this board serves a four year term (not term limited). The Federal Open Market Committee is the official policy-making body; it is made up of the members of the Board of Governors and five of the district bank presidents.

b. Define monetary policy.

Monetary Policy

Changes in the supply of money and the availability of credit initiated by a nation's central bank to promote price stability, full employment and reasonable rates of economic growth.

c. Describe how the Federal Reserve uses the tools of monetary policy to promote price stability, full employment, and economic growth.

The Fed has a number of monetary policy tools it can use to promote price stability, full employment, and economic growth (three are listed below):

Open Market Operations

The buying and selling of government bonds (securities) by the Federal Reserve to control bank reserves and the money supply. To increase the availability of money the Fed buys government bonds (securities). To tighten the availability of money the Fed sells bonds (securities).

Discount Rate

The interest rate the Federal Reserve charges commercial banks for loans. A change in the discount rate can either inhibit or encourage financial institutions' lending and investment activities by making it more or less expensive for them to obtain funds.

Federal Funds Rate

The interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight.

Reserve Requirements

The fraction of banks' deposits that they are required by law to keep on hand or with the Federal Reserve. Lower reserve requirements mean banks can loan out a higher percentage of deposits, higher reserve requirements mean banks must keep a higher percentage of deposits in the vault.

SSEMA3 The student will explain how the government uses fiscal policy to promote price stability, full employment, and economic growth.

a. Define fiscal policy.

Fiscal Policy

Changes in the expenditures or tax revenues of the federal government, undertaken to promote full employment, price stability and reasonable rates of economic growth.

b. Explain the government's taxing and spending decisions.

Government taxation

Funds raised through taxing and borrowing to pay for government expenditures. The amount of government taxation depends on a number of factors including political ideology, the state of the economy and the political climate.

Government expenditures

Goods and services provided by government and paid for by taxing and borrowing. Federal government expenditures include national defense and a system of justice. State and local government expenditures include police, roads and public education. The amount of government spending depends on a number of factors including political ideology, the state of the economy and the political climate.

SSEPF3 The student will explain how changes in the monetary and fiscal policy can impact an individual's spending and savings choices.

a. Give examples of who benefits and who loses from inflation.

Inflation is an increase in the average price level in the economy. Inflation benefits borrowers (people who owe money). People who lose from inflation are those who

loan money to others. Anyone with a savings account and anyone on a fixed income (retirees, disabled vets) loses from inflation.

b. define progressive, regressive and proportional taxes.

Progressive Tax

A tax that takes a larger percentage of income from people in higher-income groups than from people in the lower-income ones; the U.S. federal income tax is an example.

Regressive Tax

A tax that takes a larger percentage of income from people in lower-income groups than from higher-income ones. Sales taxes and excise taxes are examples.

Proportional Tax

A tax that takes the same percentage of income from people in all income groups. For many people, the Social Security tax is proportional as it takes 6.2% of gross income up to \$106,800 as of 2009.

c. explain how an increase in sales tax affects different income groups.

Sales Tax

Tax in the form of a percent of the cost of a good or service; paid to local and state governments when goods and services are purchased. The more goods or services purchased by an individual, the more that individual pays in sales tax. Therefore, the wealthy pay a lower percentage of their income to buy basic goods and services (e.g. food and clothing) than do the poor.



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